NaSIA ADVISORY NOTE ON THE ECONOMY:

NAMIBIA'S BUDGET DEFICIT AND ITS FUNDING

RESEARCH AND ECONOMIC SAVINGS POLICY DEVELOPMENT COMMITTEE

October 2020

KH Egumbo (Chairman) | AB Bertolini | M Cloete | HI Erlank | BM Ghirmatsion
PB Heuer | J Lötter | G Marais | JS Mwatotele | M Ntinda | GJ Ochse | GA Rukoro | TAMN Shejavali
TJR Stears | J van der Westhuizen | JA Vermeulen

Executive Summary

Economic analysts in Namibia are of the opinion that the fiscal position of the country has been declining over the past years. Against the backdrop of the COVID19 pandemic, measured as a percentage of GDP, the consolidated *budget* deficit is estimated to be 4.5% in 2019/20, widening to 12.5% in *2020*/21.[1] This begs the question; how do we finance this huge budget deficit? Not only to get through the 2020/21 fiscal year but for long-term and in a sustainable fashion. A clear strategy is needed to manage the deficit and avoid the risk of debt trap. There is an urgent need to seek alternative funding sources especially for infrastructure projects.

This paper examines Namibia's fiscal position from 2010/11 to 2019/20 and goes on to make several suggestions on how the present approach to debt management could be improved. Further recommendations were also made as potential solutions to consider.

The key recommendations suggested by this paper are the following:

- Tax breaks for SMMEs to improve working capital, encourage reinvestment in the business and therefore help accelerate growth;
- Develop a country strategy that is inclusive. The Fourth Industrial Revolution (IR 4.0) should be led by SME's;
- Country policy needs to be conductive for local and foreign direct investment (i.e. policy should be clear, provide comfort and certainty to investors and not be ambiguous.)
- Recapitalise the Development Bank of Namibia to boost their capacity to provide grants & concessional loans;
- To partner with private sector organisations like the GIZ, TechHub, Dololo to build a start-up culture in Namibia;
- To improve Namibia's rankings in the Ease of Doing Business survey;
- To increase education of the public regarding the benefits of investing in capital markets;
- To attract capital flows and encouragement of foreign participation;
- Moving to automated systems across all markets;
- Demutualizing the stock exchanges to improve governance from separate ownership;
- List some government properties on the NSX so that government can raise funds and citizens can in turn own local assets;
- To privatize SOEs to increase private sector activity in the economy and adopt efficiency in key service delivery institutions through techniques commonly employed by the private sector;
- To strengthen boards and management of SOEs that government opts to retain to increase efficiency and service delivery that ultimately leads to economic growth in the long run;
- To develop projects with tangible, quantifiable benefits;
- To engage and align community stakeholders to promote inclusive economic and social benefits;
- To allow sources of funding for infrastructure to be informed by financing costs, operational costs and political factors;
- To invest in water infrastructure to assist and de-risk the agriculture industry from climate change, attract investment, upscale agro-processing and agriculture production. Increasing the water capacity will also ordinarily attract investments in mining and manufacturing;
- To invest in renewable energy to increase access to electricity and reduce the need for imported electricity. This will have a positive effect on the Trade Balance as well; and
- To prioritize the provision of housing to low income groups;

[1] https://www2.deloitte.com/na/en/pages/tax/articles/Deloitte-Namibia-Namibian-Budget-Guide-2020.html#:~:text=Budget%202020%2F2021&text=Main%20budget%20items%20are%3A&text=budget%20deficit%20for%20FY2020%2F21,percent%20of%20GDP%2C%20from%2054.8

- To transfer' some of the wage bill off the public income statement to private sector (through privatisations, restructurings and PPPs);
- To re-skill the public sector workers to prepare them for a more dynamic labour market in lieu of systemic trends such as the fourth Industrial Revolution;
- To investigate early retirement cost savings;
- To conduct a skills audit on the full civil service and employees should be placed in the most appropriate positions;
- Payroll audit to be conducted to identify ghost employees (if any);
- Reforming the Public Service Employees Medical Aid Scheme (PSEMAS);
- Increasing the Offshore component of Reg 13, especially considering that offshore markets are relatively lowly correlated with both the NSX and JSE; and
- To consider increasing the unlisted ceiling from the current 3.5% to 10% as well as doing away with the floor.

1. Introduction: The summary of key concerns faced by Namibia

Government spending over the years has not resulted in sustainable growth (i.e. Government's expenditure profile is dominated by operational expenditure) and has put Namibia in a very fragile position with regards to debt sustainability. Over the last five years government revenue has grown at a slower rate than nominal GDP, a sign of stagnating business climate.[2]

Over the years, high government expenditure and rising debt servicing costs has made expanding the fiscal space for priority sectors very challenging. Additionally, foreign debt has increased as the exchange rate has depreciated materially. Reports from Bank of Namibia and the Ministry of Finance budget publications[3] for 2020/21 indicate that over the ten-year period from 2010/11 to 2020/21, total government debt increased from 16.4% of GDP, to 58.7% of GDP. Internationally, an acceptable debt-to-GDP level is around 40% for developing and emerging economies.[4] This limit should not be breached on a long-term basis otherwise fiscal sustainability will be threatened. Debt sustainability becomes an issue as debt-to-GDP is expected to push past 65% when government guarantees are added.[5] A study by the World Bank found that, for emerging markets, if the debt-to-GDP ratio exceeds 64% for an extended period it slows economic growth. Each additional percentage point of debt above 64% will slow economic growth by 2% each year.[6]

As Namibia looks to the International Monetary Fund (IMF) to fund part of its budget deficit, the classical example of Argentina (i.e. risk of debt trap and the conditions that normally accompany IMF loans) should be kept in mind.

As at 28 September 2020, nearly $16 billion of emergency financial assistance has been requested from the IMF by 40 African countries, adding to the mounting debt crisis across the continent.

Holistically, Namibia needs structural reforms to address inequality, create jobs, address crime and to spur economic growth. In order to harness Namibia's economic potential, structural reforms should move from policy to implementation in order to generate higher and sustainable growth rates. Structural reforms could include:

- Human capital development and investment;
- Improving Namibia's Ease of Doing Business ranking materially;
- Greater energy self-reliance;
- Agriculture sector de-risk and development;
- Improved Governance at SOEs;
- Partially privatizing some SOE assets;
- Reductions in the Public sector wage bill; and
- Reforming the Public Service Employees Medical Aid Scheme (PSEMAS).

---

2 Van Zyl E *et al.* (2020 May 28). *National Budget Review 2020/21 – "Approaching the Precipice".* Retrieved from https://ijg.net/research/category/economicresearch/budget/

3 https://www.bon.com.na/CMSTemplates/Bon/Files/bon.com.na/79/799b417e-66c6-4023-acf8-20ad9bf211da.pdf and https://mof.gov.na/budget

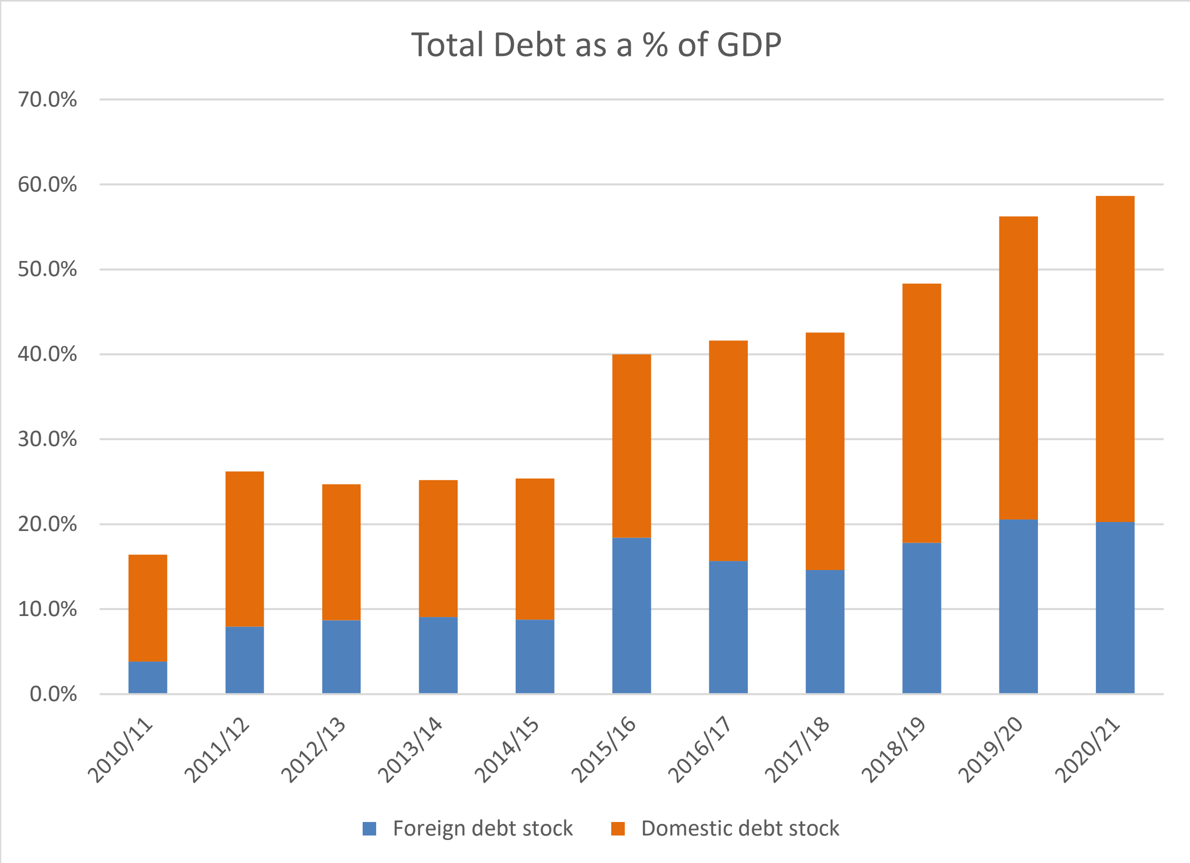
4 Chowdhury, A. (2010 November 9). *Is there an optimal debt-to-GDP ratio?* Retrieved from https://voxeu.org/debates/commentaries/there-optimal-debt-gdp-ratio#:~:text=A%20debt-to-GDP%20ratio%20of%2060%25%20is%20quite%20often,should%20not%20be%20breached%20on%20a%20long-term%20basis.

5 Van Zyl E *et al.* (2020 May 28). *National Budget Review 2020/21 – "Approaching the Precipice".* Retrieved from https://ijg.net/research/category/economicresearch/budget/

6 Amadeo, K. (2020 July 30). *Debt-to-GDP Ratio, It's Formula and How to Use it – How to tell if a country has too much debt.* Retrieved from https://www.thebalance.com/debt-to-gdp-ratio-how-to-calculate-and-use-it-3305832

Chart one below indicates the total debt as a percentage of GDP from 2010/11 to 2020/21.

Chart 1: Total Debt as a % of GDP



(Note: SOEs guarantees are excluded)
Source: BoN, NaSIA

Estimates published in this fiscal year's budget documents indicate that the sharp increase in public debt for the 2020/21 fiscal year is mainly due to the urgency of addressing the once-off needs arising from the Covid-19 impact. The economy is not expected to recover in 20/21 as most businesses will be focused on survival rather than expansion, leaving profits and taxes severely depressed.[7] IJG expects unemployment to rise by between 5 and 8 percentage points this year as the economy contracts by the most on record.

The 2020/21 fiscal year has a revenue shortfall of N$21.4 billion. This will cause government debt to increase to N$119.1 billion. Currently the total budgeted revenue stands at N$51.4 billion. The total budgeted expenditure currently stands at N$72.8 billion. In 2015 the GDP/Capita peaked at US$ 6,274 (Constant 2010) where after it went down to US$ 5,766 in 2019.[8]

It should be kept in mind that any type of structural reforms can take time to produce higher growth and create much needed jobs. It is thus a difficult task to convince stakeholders that the painful effects structural reforms

[7] Van Zyl E *et al.* (2020 May 28). *National Budget Review 2020/21 – "Approaching the Precipice".* Retrieved from https://ijg.net/research/category/economicresearch/budget/
[8] https://data.worldbank.org/indicator/NY.GDP.PCAP.KD?end=2019&locations=NA&start=2011

would cause is temporary and would eventually lead to long-term gains. However, if reforms are implemented successfully, the country can reap significant benefits. Some of the countries that achieved success with implementing structural reforms in the past include: Brazil, Malaysia, Peru, Tanzania and Turkey.[9] Fiscal and economic policy reform will need to be rapid if Namibia is to return to a growth trajectory that will improve the living standards and reduce unemployment.

2. Other solutions:

2.1 Enterprise Development

Enterprise development entails helping Small Medium and Micro Enterprises (SMME) establish, grow or improve by investing time, knowledge and capital. SMME development is the most effective means to creating jobs in Namibia which has had structurally high and persistent unemployment for many years. In the USA, a dynamic entrepreneurially driven economy with some of the largest businesses in the world, SMME's account for 47.3% of total employment[10].

Recommendations:

a) Tax breaks for SMMEs to improve working capital, encourage reinvestment in the business and therefore help accelerate growth;
b) Develop a country strategy that is inclusive. The Fourth Industrial Revolution (IR 4.0) should be led by SME's;
c) Country policy needs to be conductive for local and foreign direct investment (i.e. policy should be clear, provide comfort and certainty to investors and not be ambiguous.)
d) Recapitalise the Development Bank of Namibia to boost their capacity to provide grants & concessional loans;
e) Partner with private sector organisations like the GIZ, TechHub, Dololo to build a start-up culture in Namibia;
f) Improve Namibia's rankings in the Ease of Doing Business survey. Namibia is currently ranked 104th globally (behind peers Botswana (87th), Zambia (85th) and South Africa (84th)). In Africa, Mauritius is the country to emulate with a ranking of 13th in the world[11]. The aspects of "Ease of Doing Business" that we should work on urgently are: Starting a Business (ranked 165th), Registering Property (ranked 173rd), Trading Across Borders (ranked 138th) and Resolving Insolvency (ranked 127th);

2.2 Capital markets deepening and development

Capital markets play an essential role in financing infrastructure development, large enterprises, and SMMEs.[12] Increasing provision of financial services through deepening capital markets, leads to lower cost of financial intermediation through an increase in both the range and variety of financial instruments accessible to savers and investors. This also stimulates economic growth and leads to a sector that can mobilize and channel savings more effectively to productive investments. Additionally, a deepened Financial sector enhances portfolio diversification.[13] However, there are challenges in deepening capital markets as they are dependent on the

---

[9] Malinga, S. (2018 October). *A way forward for structural reform*. Retrieved from https://www.prudential.co.za/insights/articlesreleases/a-way-forward-for-structural-reform/

[10] https://smallbiztrends.com/small-business-statistics#:~:text=Small%20businesses%20employ%2059.9%20million,private%20workforce%20excludes%20government%20workers.

[11] https://www.doingbusiness.org/en/rankings#:~:text=Ease%20of%20Doing%20Business%20rankings&text=Economies%20are%20ranked%20on%20their,business%2C%20from%201%E2%80%93190.&text=The%20rankings%20are%20determined%20by,are%20benchmarked%20to%20May%202019.

[12] Cytonn Report. (2019 March 24). *The Role of the Capital Markets in Economic Development.* Retrieved from https://cytonnreport.com/topicals/the-role-of-the-capital-markets-in-economic-development

[13] Namibia Financial Sector Strategy 2011-2021 A Sector Development Document Towards Achieving Vision 2030

level of economic and structural development of a country. The following factors affect the development of capital markets:

- **Access to information:** Allows for the monitoring of users of funds and gives investors' confidence in the functioning of the capital markets.
- **Knowledge of Retail investors:** Retail investors needs to be educated on investment products as well as the benefits of saving. This will channel savings to capital markets.
- **Market Infrastructure:** Adequate and efficient market infrastructure is very essential as a lack thereof pushes away potential investors.
- **Diverse Financial instruments:** To create diverse investment opportunities
- **Regulatory Framework:** Adequate regulation of investors, users of funds, and intermediaries are critical.
- **Macroeconomic Policies Framework:** Sound macroeconomic policy frameworks is essential for well-functioning capital markets. This will also result in investor confidence as they will be confident that factors such as hyper-inflation and exchange rate risks will not affect their capital as there will be a strong macroeconomic framework in place.

According to the Namibian financial sector strategy report[14], Namibia's financial system although relatively well developed, is not considered deep enough. There are shortcomings that need to be addressed to enable the financial sector to contribute meaningfully to the overall performance of the country's economy. Currently, the accessible instruments in the money market fall short of expectations (i.e. we do not have electronic trading) and the bond market is Government dominated with only a few public and private institutions. Furthermore, the secondary market is relatively illiquid. These shortcomings hinder funds from effectively moving into productive investments.

The speedy implementation of the Financial Markets Bill is therefore critical, as it will enable the demutualization of the NSX, the implementation of the Central Securities Depository (CSD) and the online trading platform.

2.3 Privatisation of SOE's

Another aspect to consider is to sell, merge and/or list some of the state-owned enterprises (SOE's). A large part of our country's wealth is contained in SOE assets that operate in the energy, transportation, communication, education, water and financial sectors. Most SOEs have over the years been financially distressed and inefficient (evidenced by constant bail outs).[15] This hampers services delivery, economic competitiveness and stagnates innovation in key economic sectors. Some of these assets can be sold by the government to finance productive expenditure and relieve liquidity constraints. However, such sales needs to be carefully considered as the sale of assets may result in the loss of government revenue in future years.[16] Privatisation of some SOEs is encouraged in order to expand the scope of private sector activity in the economy and adopt efficiency in key service delivery institutions through techniques commonly employed by the private sector. Additionally, government should strengthen boards and management of SOEs they opt to retain to increase efficiency and service delivery that ultimately leads to economic growth in the long run.

https://www.bon.com.na/CMSTemplates/Bon/Files/bon.com.na/e7/e7e69c6d-b02b-4109-8d3d-5b41a79f9d89.pdf

[14] Namibia financial sector strategy 2010-2020 https://www.rfin.com.na/wp-content/uploads/2017/07/FSS2010-2020.pdf

[15] High-Level Panel on the Namibian Economy. (2020). Final report with recommendations. Prepared for submission to president.

[16] Brandt, E. (2019 March 5). *Namibia: Economic Growth is the best way to reduce the budget deficit – Likukela*. Retrieved from https://allafrica.com/stories/201903050461.html

Recommendations:

a) List some government properties on the NSX so that government can raise funds and citizens can in turn own local assets;
b) Privatize SOEs to increase private sector activity in the economy and adopt efficiency in key service delivery institutions through techniques commonly employed by the private sector; and
c) Strengthen boards and management of SOEs that government opts to retain to increase efficiency and service delivery that ultimately leads to economic growth in the long run.

2.4 Infrastructure Investment

Infrastructure development lies at the nexus of economic growth, productive investment, job creation, and poverty reduction. Thus, investing in infrastructure such as water, energy, housing, transportation, and telecom systems, underpins economic activity and catalyses growth and development. The following two key best practices can assist the government to modernize decision making for infrastructure and to improve its social and economic impact.

1. Develop projects with tangible, quantifiable benefits:

The objective is to set up a pipeline of high-quality projects with clear metrics supporting their contribution to social and economic growth and to do so in a transparent manner. To achieve this objective, selection of projects that need funding should be founded on reliable data and analytics, robust financial models and designs that meet the needs of citizens. They ought to consider both the immediate effect and the indirect impacts of the project on the rest of the economy and society.

2. Improve the coordination of infrastructure investments to account for network effects:

In this regard, the government needs to look at whether an investment is compatible with existing infrastructure, particularly when the investment forms part of a network, such as transportation or power grids. In developing and emerging market economies, research has shown that the marginal benefit of investing in infrastructure is highest when it adds to an existing but not fully mature network.[17] This implies that, coordinating investments to create additional linkages in an immature network generates more benefits than adding to a mostly complete one. Therefore, the Namibian government should make decisions at a portfolio level to account for these network effects and assess projects as part of a system rather than in isolation.

Recommendations:

a) Develop projects with tangible, quantifiable benefits;
b) Engage and align community stakeholders to promote inclusive economic and social benefits;
c) Allow sources of funding for infrastructure to be informed by financing costs, operational costs and political factors;
d) Invest in water infrastructure to assist and de-risk the agriculture industry from climate change, attract investment, upscale agro-processing and agriculture production. Increasing the water capacity will also ordinarily attract investments in mining and manufacturing;
e) Invest in renewable energy to increase access to electricity and reduce the need for imported electricity. This will have a positive effect on the Trade Balance as well; and
f) Prioritize the provision of housing to low income groups.

[17] Christophe Hurlin, *Network effects of the productivity of infrastructure in developing countries*, World Bank working paper, Policy Research Series, WPS3808, January 2006, documents.worldbank.org.

2.5 Public Sector Wage Bill

Periods of crisis provide opportunity to address some key underlying issues such as the size and growth path of the public sector wage bill which now typically accounts for more than half of the government's revenue. There was already a big disparity[18] between private and public sector wages before and this will be amplified now as pay-cuts materialise in the private sector while public sector wages remain intact.

Recommendations:

a) 'Transfer' some of the wage bill off the public income statement to private sector (through privatisations, restructurings and PPPs);
b) Re-skill public sector workers to prepare them for a more dynamic labour market in lieu of systemic trends such as the fourth Industrial Revolution;
c) Early retirement cost savings to be investigated;
d) A skills audit to be conducted on the full civil service and employees should be placed in the most appropriate positions;
e) Payroll audit to be conducted to identify ghost employees (if any);
f) Reforming the Public Service Employees Medical Aid Scheme (PSEMAS).

2.6 Improving retirement savings and Regulation 13 of the Pension Fund Act of 1956

A lot of Namibian households do not save enough for retirement. It often happens that the contributions are too little, funds are poorly invested, or funds are withdrawn too early.[19]

Reformation of the industry is another crucial component. South Africa is a good example as far as pension/retirement industry reform is concerned. Reforms in South Africa, which took effect from 1 March 2016, allowed for greater tax deductibility of the employee's and employer's total pension contributions up to a limit of the lesser of R350 000 pa or 27.5% of annual remuneration.

The former Minister of Finance, Calle Schlettwein, announced in his final annual national budget speech in March 2019, that the tax deductible tax threshold would increase from N$40 000 per annum to 27.5 percent of annual income capped at N$150 000 per annum.

Reform the retirement industry:

a) Increase the Offshore component of Reg 13, especially considering that offshore markets are relatively lowly correlated with both the NSX and JSE;
b) Consider increasing the unlisted ceiling from the current 3.5% to 10% as well as doing away with the floor. The 10% however, should never be something that players in this sector should strive towards. Another reason for the increase is that even for the smaller pension funds, the 3.5% ceiling doesn't make sense as it is too expensive for them to access. Given the lacklustre performance of the Namibian economy for the past few years, the economy will benefit from increased infrastructure investments. For pension fund money to truly have a meaningful impact on the local economy, this limit should be increased. Removing the floor will therefore go a long way in giving the unlisted sector flexibility to innovate; and
c) It should however be noted that the continuous increase of the local asset requirement has its own draw backs (i.e. concentration risk/lack of diversification) and should be approached with the end consumer/saver/pensioner in mind.

[18] As evidenced by the work done by the Growth Lab for example.
[19] The structure and nature of savings in Namibia https://www.bon.com.na/CMSTemplates/Bon/Files/bon.com.na/c5/c54525f3-6d19-482c-a11f-e5921a133060.pdf

3. Conclusion

Evidently, we urgently need new strategies that can allow the country to address unemployment, inequality, and poverty. Keeping it business as usual could lead to public debt reaching unsustainable levels, lead to less competitiveness, promote instability and increase in social tension. In order to avoid a debt trap and a possible bail-out from the IMF, it is encouraged to reduce the large recurring operational budget expenditure in order to avail more resources for key infrastructure projects. There is a need for efficient public investment which is spending on infrastructure that crowds in private investment. In conclusion, a stable and investor-friendly policy framework is the key-overarching prerequisite to getting back onto a sustainable growth trajectory.